THE IMPACT OF ESG, OPERATIONAL CAPACITY, CLAIMS RATIO, AND LIQUIDITY ON FINANCIAL DISTRESS WITH MODERATION OF RISK-BASED CAPITAL IN INSURANCE COMPANIES IN INDONESIA

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Abstrak

This study aims to test and analyze the effect of Environmental, Social, and Governance (ESG) performance, operational capacity, claims ratio, and liquidity on financial distress in insurance companies in Indonesia, with Risk-Based Capital (RBC) as a moderating variable. Utilizing a quantitative approach, the research involves a saturated sampling technique and focuses on 18 insurance companies listed on the Indonesian Stock Exchange (IDX). Regression analysis using panel data, supported by Eviews 12, reveals that ESG performance and liquidity do not significantly affect financial distress. Operational capacity positively influences financial distress, while claims ratio negatively impacts it. Additionally, RBC does not moderate the relationship between ESG or liquidity and financial distress, but it does moderate the effect of operational capacity and claims ratio on financial distress. These findings contribute to understanding the financial stability of insurance companies in Indonesia.

Keywords: ESG, Operational Capacity, Claims Ratio, Financial Distress, Risk-Based Capital

INTRODUCTION

The insurance industry plays a significant role in ensuring economic stability by mitigating risks for both individuals and businesses. However, despite its essential role, insurance companies frequently face financial distress, which can negatively affect their operational continuity and impact the broader economy. Financial distress in this context can result from a variety of factors, including poor ESG (Environmental, Social, and Governance) performance, insufficient operational capacity, high claims ratios, and liquidity issues. Risk-Based Capital (RBC), as a regulatory standard, is often seen as a moderating factor that helps insurance companies manage their financial stability by ensuring they have adequate capital to cover potential risks. This study aims to investigate the effects of ESG performance, operational capacity, claims ratio, and liquidity on financial distress in Indonesian insurance companies, with RBC functioning as a moderating variable. By focusing on the Indonesian market, this research contributes to the existing body of knowledge by exploring the relationship between ESG performance and financial distress within the insurance sector, which remains under-researched in the context of Indonesia. Additionally, this study sheds light on RBC's role in moderating the relationship between these financial and non-financial factors and financial distress, expanding the theoretical understanding of RBC's moderating impact. The research findings have both theoretical and practical implications: from a theoretical standpoint, this study enriches the literature on financial distress by demonstrating how ESG performance, operational capacity, claims ratios, and liquidity contribute to financial distress, particularly in the insurance industry. Practically, the results provide actionable insights for insurance companies to improve their risk management strategies, emphasizing the importance of optimizing operational capacity and managing claims ratios to prevent financial distress. Furthermore, the study underscores the value of RBC as a stabilizing tool for ensuring long-term financial health in the face of varying operational challenges. The results indicate that while ESG performance and liquidity have no significant impact on financial distress, operational capacity has a positive effect, and the claims ratio has a negative effect on financial distress. Additionally, RBC is shown to moderate the relationship between operational capacity and claims ratio with financial distress, but it does not moderate the relationship between ESG or liquidity and financial distress. These findings highlight the need for insurance companies to prioritize improving operational capacity, managing claims ratios effectively, and strategically implementing RBC to mitigate financial distress risks and ensure financial resilience in an increasingly complex and competitive market. These insights also offer guidance to policymakers and industry stakeholders who aim to enhance the regulatory framework and financial sustainability of insurance companies in Indonesia (Pujiharto, 2019; Manggarini, 2023; Isayas, 2021).

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Financial distress has long been a topic of interest in financial management, particularly in the insurance industry where financial health is crucial for the sustainability of operations. According to Altman (1993), financial distress is characterized by a company's inability to meet its financial obligations, potentially leading to bankruptcy. Recent studies have indicated various determinants of financial distress, including corporate governance, operational capacity, and financial performance (Isayas, 2021).

In the context of insurance companies, several studies highlight that high claims ratios and poor liquidity management can significantly increase the risk of financial distress (Pujiharto, 2019). Furthermore, the growing importance of environmental, social, and governance (ESG) practices has led to research examining its impact on a company's long-term stability and financial health. ESG performance, particularly in terms of governance and environmental practices, can influence an insurer's risk profile by affecting stakeholder trust and regulatory compliance (Ferrell, 2021).

Risk-Based Capital (RBC) is a regulatory measure used to assess the financial health of insurance companies by ensuring they have enough capital to cover their risks. RBC is critical in moderating the relationship between operational factors like capacity and claims ratio with financial distress (Manggarini, 2023). Recent literature suggests that RBC can help buffer the effects of adverse financial conditions on insurers, reducing their likelihood of experiencing financial distress (Siswanti et al., 2024).

The formulation of hypotheses is based on the theoretical background and empirical evidence presented in the literature review. It is hypothesized that:

H1: Operational capacity has a positive effect on financial distress in Indonesian insurance companies.

This hypothesis is based on the argument that insurance companies with inefficient operational capacities are more vulnerable to financial distress, as they may struggle to manage their resources effectively (Pujiharto, 2019).

H2: Claims ratio has a negative effect on financial distress in Indonesian insurance companies. As a high claims ratio indicates a higher proportion of premiums are used to pay out claims, it directly impacts an insurer's ability to meet its financial obligations, increasing the likelihood of financial distress (Isayas, 2021).

H3: Liquidity has a negative effect on financial distress in Indonesian insurance companies. Liquidity is a critical factor for insurance companies, as inadequate liquidity can prevent them from fulfilling their short-term obligations, leading to increased financial distress risk (Pujiharto, 2019).

H4: ESG performance has a significant effect on financial distress in Indonesian insurance companies.

This hypothesis posits that better ESG performance, particularly in governance and environmental factors, helps insurance companies maintain long-term stability by enhancing their risk management practices (Ferrell, 2021).
H5: Risk-Based Capital moderates the relationship between operational capacity and financial distress in Indonesian insurance companies.
RBC is expected to buffer the negative impact of poor operational capacity on financial distress by ensuring adequate capital reserves are available (Manggarini, 2023).
H6: Risk-Based Capital moderates the relationship between claims ratio and financial distress in Indonesian insurance companies.
RBC can moderate the negative effects of a high claims ratio by ensuring that the insurance company has enough capital to absorb claims-related losses, reducing the likelihood of financial distress (Siswanti et al., 2024).
H7: Risk-Based Capital moderates the relationship between liquidity and financial distress in Indonesian insurance companies.
Adequate RBC can help insurance companies manage liquidity challenges by providing a financial buffer during periods of low liquidity, thus decreasing the risk of financial distress (Manggarini, 2023).H8: Risk-Based Capital moderates the relationship between ESG performance and financial distress in Indonesian insurance companies.
RBC can strengthen the positive impact of ESG performance on financial stability by ensuring that insurance companies with strong ESG practices are well-capitalized to weather financial crises (Siswanti et al., 2024).

RESEARCH METHODS

This section outlines the methodology used in this research, which includes the research design, population and sample, data collection techniques, and data analysis methods. The research methodology is explained in detail to ensure the study's reliability and validity.

1. Research Design
   This research adopts a quantitative approach with a cross-sectional design. It aims to analyze the relationships between Environmental, Social, and Governance (ESG) performance, operational capacity, claims ratio, liquidity, and financial distress in Indonesian insurance companies, with Risk-Based Capital (RBC) as a moderating variable. The study uses a regression analysis method with panel data, allowing for a comprehensive understanding of the impact of these variables on financial distress.
2. Population and Sample
   The population for this research consists of insurance companies listed on the Indonesian Stock Exchange (IDX) that are recognized by the Financial Services Authority (OJK). The sample is determined using a purposive sampling technique, selecting 18 insurance companies based on their availability of complete data for the study period (2018–2023). These companies represent a diverse range of operational scales and financial conditions, allowing for a robust analysis of the research variables.
3. Data Collection Techniques and Instrument Development
   The data collection process involves secondary data obtained from publicly available financial reports, including annual reports, financial statements, and disclosures related to ESG performance from the companies in the sample. The variables used in the study, such as ESG performance, operational capacity, claims ratio, liquidity, and RBC, are measured using indicators commonly found in industry reports and previous research. ESG performance is measured based on environmental, social, and governance indices, operational capacity is assessed using total asset turnover, claims ratio is calculated as the ratio of claims paid to premiums received, liquidity is measured by the current ratio, and RBC is obtained from

financial disclosures. The instruments used for data collection are financial ratios and performance indices, which have been validated in previous studies.

4. Data Analysis Techniques
Data analysis is conducted using regression analysis with panel data, which is suitable for analyzing data collected over time and across different companies. The regression models test the hypothesized relationships between the independent variables (ESG, operational capacity, claims ratio, and liquidity) and the dependent variable (financial distress), with RBC acting as a moderating variable. The data is analyzed using statistical software, such as Eviews 12, to estimate the regression coefficients and test the hypotheses. The analysis also includes tests for multicollinearity, heteroscedasticity, and other assumptions to ensure the validity of the results.

For qualitative research, such as case studies or ethnography, it is important to clarify the role of the researcher, the subjects or informants involved, the location, and the duration of the study. In this quantitative study, however, the research relies on numerical data, and the focus is on secondary data analysis. Data validity is checked through consistency and completeness of the secondary data collected from the sample companies' financial reports.

RESULTS AND DISCUSSION

This section presents the results of the data analysis and hypothesis testing, followed by a discussion of the findings. The results are explained in detail, and relevant tables and figures are included to illustrate key points. The discussion aims to answer the research questions, interpret the findings, relate them to existing theories, and suggest potential theoretical implications.

Results of Hypothesis Testing

The regression analysis was conducted to test the relationships between ESG performance, operational capacity, claims ratio, liquidity, and financial distress, with RBC as a moderating variable. The hypotheses were formulated to explore the effects of these variables on financial distress in Indonesian insurance companies.

H1: Operational capacity has a positive effect on financial distress in Indonesian insurance companies.

The results show a positive and statistically significant relationship between operational capacity and financial distress ($p < 0.05$). This finding suggests that companies with inefficient operational capacity are more likely to experience financial distress. This aligns with prior research that has indicated that operational inefficiencies can increase the vulnerability of firms to financial challenges (Pujiharto, 2019; Isayas, 2021).

H2: Claims ratio has a negative effect on financial distress in Indonesian insurance companies. The claims ratio was found to have a significant negative effect on financial distress ($p < 0.01$). This indicates that a higher claims ratio, which represents a greater proportion of premiums used to cover claims, is associated with a higher likelihood of financial distress. This result supports the findings of Isayas (2021), who noted that a high claims ratio reduces a company's financial stability, and is consistent with earlier studies on the insurance industry (Manggarini, 2023).

H3: Liquidity has a negative effect on financial distress in Indonesian insurance companies. Liquidity was not found to have a significant effect on financial distress in this study ($p > 0.05$). This result suggests that, unlike other industries, liquidity may not be as critical for insurance companies in preventing financial distress, possibly due to the industry's reliance on long-term investments and risk management strategies. This contrasts with studies such as Pujiharto (2019) and Isayas (2021), where liquidity was found to be an important determinant of financial distress.

H4: ESG performance has a significant effect on financial distress in Indonesian insurance companies.

ESG performance, measured through governance and environmental indicators, was found to have no significant impact on financial distress ($p > 0.05$). This suggests that, although ESG performance is important for long-term sustainability, it may not directly influence financial distress in the short term for Indonesian insurance companies. This finding is consistent with the research of Ferrell (2021), which highlighted that ESG practices are more correlated with long-term growth rather than immediate financial stability.

H5: Risk-Based Capital moderates the relationship between operational capacity and financial distress in Indonesian insurance companies.

RBC was found to significantly moderate the relationship between operational capacity and financial distress ($p < 0.05$). This means that insurance companies with higher RBC levels are better equipped to mitigate the negative effects of operational inefficiencies on financial distress, confirming the role of RBC in enhancing financial resilience (Siswanti et al., 2024; Manggarini, 2023).

H6: Risk-Based Capital moderates the relationship between claims ratio and financial distress in Indonesian insurance companies.

The analysis showed that RBC significantly moderates the relationship between claims ratio and financial distress ($p < 0.01$). This finding suggests that companies with sufficient RBC are more capable of handling high claims ratios without facing severe financial distress, supporting the importance of capital reserves in managing risks (Siswanti et al., 2024; Manggarini, 2023).

H7: Risk-Based Capital moderates the relationship between liquidity and financial distress in Indonesian insurance companies.

RBC did not significantly moderate the relationship between liquidity and financial distress ($p > 0.05$). This may indicate that liquidity issues are not as mitigated by RBC as other financial factors, such as operational capacity or claims management. The study's results are in line with the findings of Isayas (2021), where liquidity issues remained a critical factor independent of capital reserves.

H8: Risk-Based Capital moderates the relationship between ESG performance and financial distress in Indonesian insurance companies.

RBC was found to have a moderate effect on the relationship between ESG performance and financial distress, but the effect was not statistically significant ($p > 0.05$). This suggests that while RBC helps buffer financial risks, it may not directly influence the relationship between ESG and financial distress in the short term. This finding is consistent with earlier studies on RBC's moderating role (Siswanti et al., 2024).

Discussion

The results of this study provide valuable insights into the factors contributing to financial distress in Indonesian insurance companies. The positive relationship between operational capacity and financial distress (H1) emphasizes the importance of improving operational efficiency. Insurance companies with inefficient operations are more likely to experience financial challenges, highlighting the need for better resource management and cost control.

The significant negative effect of the claims ratio on financial distress (H2) reinforces the importance of managing claims effectively. Insurance companies should focus on balancing the claims ratio to ensure financial stability, as a higher claims ratio reduces the company's ability to meet financial obligations and increases the risk of distress. This result is consistent with previous studies (Isayas, 2021; Pujiharto, 2019).

Interestingly, liquidity (H3) did not have a significant effect on financial distress in this study, which contradicts traditional views in financial management. This finding suggests that, for insurance companies in Indonesia, liquidity may not be as critical a factor for financial distress as other operational or market factors, such as claims management. This result contrasts with the work of Isayas (2021) and Pujiharto (2019), who emphasized liquidity as a key determinant.

The lack of significant findings for ESG performance (H4) challenges the conventional wisdom that strong ESG practices directly contribute to financial stability. While ESG may be important for long-term growth and risk management, its immediate impact on financial distress may be limited in the short term. This finding aligns with Ferrell (2021), who argued that ESG is more related to long-term sustainability than to short-term financial outcomes.

The moderating role of RBC in the relationship between operational capacity, claims ratio, and financial distress (H5, H6) confirms its significance as a stabilizing factor for insurance companies facing financial challenges. Companies with higher RBC levels are better equipped to withstand operational inefficiencies or high claims, reinforcing the importance of adequate capital reserves. This is consistent with the findings of Siswanti et al. (2024) and Manggarini (2023), who noted RBC's role in buffering against financial distress.

However, RBC's lack of significance in moderating the relationship between liquidity and financial distress (H7) suggests that liquidity issues are less effectively managed through capital reserves alone, indicating the need for more robust liquidity management practices in the industry.

Lastly, the finding that RBC does not significantly moderate the relationship between ESG performance and financial distress (H8) suggests that RBC's effectiveness in moderating financial distress is more pronounced in operational and financial factors than in non-financial factors like ESG. This implies that while RBC can provide a cushion against financial risks, it may not fully address the complexities of managing ESG-related issues.

These results contribute to the theoretical understanding of financial distress in insurance companies and provide practical implications for managers in the industry. Companies should focus on improving operational efficiency, managing claims effectively, and maintaining adequate RBC levels to mitigate the risk of financial distress. Additionally, regulators should consider the role of RBC in enhancing financial stability and reducing distress risks in the insurance sector.

CONCLUSION

This research aimed to examine the effects of ESG performance, operational capacity, claims ratio, and liquidity on financial distress in Indonesian insurance companies, with Risk-Based Capital (RBC) serving as a moderating variable. The findings of the study provide valuable insights into the factors influencing financial distress in the insurance sector, particularly in Indonesia. The results revealed that operational capacity and claims ratio have a significant impact on financial distress, while liquidity and ESG performance do not directly affect financial distress in the short term. Additionally, RBC was found to moderate the relationship between operational capacity and claims ratio with financial distress, but it had no significant moderating effect on liquidity or ESG performance.

Implications

The practical implications of this study suggest that insurance companies in Indonesia should focus on improving their operational efficiency and managing claims effectively to reduce the risk of financial distress. Moreover, regulators and policymakers should consider the role of RBC as an essential tool for enhancing financial stability in the insurance industry. The results also imply that while ESG performance is important for long-term sustainability, it may not have an immediate impact on financial distress, which could be a consideration for future regulatory frameworks.

Limitations

There are several limitations in this study that could be addressed in future research. First, the study relied on secondary data from publicly available financial reports, which may limit the depth of information on non-financial factors like ESG practices. Second, the study focused on insurance companies listed on the Indonesian Stock Exchange (IDX), which may not fully represent the broader insurance market in Indonesia. Future research could expand the sample to include both listed and non-listed insurance companies to provide a more comprehensive understanding of the issue. Third, this study focused on short-term financial distress, while future studies could explore long-term sustainability and the role of strategic management practices in mitigating financial distress.

Suggestions for Future Research

Future research could explore the impact of ESG practices on long-term financial performance and sustainability in the insurance industry, considering factors beyond immediate financial distress. It would also be valuable to investigate the role of governance structures in managing operational capacity and claims ratio more effectively. Additionally, exploring the moderating effects of other variables, such as market competition, government regulations, and macroeconomic factors, could provide a more holistic view of the financial distress in the insurance sector. Lastly, further studies could use qualitative methods, such as interviews or case studies, to gain a deeper understanding of how insurance companies implement ESG practices and manage financial distress.

(tambahkan gambar)

Figure 1. Conceptual Framework

Table 1 Results of Panel Data Regression (Random Effect Model)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-15.99328	26.33351	-0.607336	0.5450
KINERJA_ESG	-2.738031	2.286879	-1.197278	0.2341
KAPASITAS_OPERASIONAL	97.29392	36.41495	2.671812	0.0088
RASIO_KLAIM	-246.7311	102.2239	-2.413635	0.0176
LIKUIDITAS	-11.27739	11.99359	-0.940285	0.3494
KINERJA_ESG*RISK_BASED_CAPITAL	-0.000398	0.000320	-1.245486	0.2159
KAPASITAS_OPERASIONAL*RISK_BASED_CAPITAL	0.013472	0.005241	2.570351	0.0116
RASIO_KLAIM*RISK_BASED_CAPITAL	-0.035857	0.014311	-2.505549	0.0139
LIKUIDITAS*RISK_BASED_CAPITAL	-0.001824	0.001660	-1.098791	0.2745
	Effects Specification			
			S.D.	Rho
Cross-section random			10.46655	0.4362
Idiosyncratic random			11.89925	0.5638
	Weighted Statistics			
Root MSE	11.08217	R-squared		0.251997
Mean dependent var	-33.90219	Adjusted R-squared		0.191553
S.D. dependent var	12.87340	S.E. of regression		11.57495
Sum squared resid	13263.96	F-statistic		4.169061
Durbin-Watson stat	1.902568	Prob(F-statistic)		0.000250
	Unweighted Statistics			
R-squared	0.253227	Mean dependent var		-80.52861
Sum squared resid	20279.04	Durbin-Watson stat		1.244417

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